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OCT 27 1993

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October 19, 1993

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

93-215

Re: Notification of Permitted Written Ex Parte
Presentation in MM Docket Nos. 92-266 & 93-215/

Dear Mr. Caton:

ParCable, Inc., Star Cable Associates, Bend Cable Communications, Inc., Etan Industries, Inc. and River Valley Cable TV, by their attorneys and pursuant to Section 1.1206(a)(1) of the Commission's rules, hereby submits two copies of this memorandum regarding a permitted ex parte presentation to Commission officials regarding MM Docket Nos. 96-266 & 93-215.

Today at 1:30 p.m., Michael Grannon of ParCable, Inc. along with Donna C. Gregg and Peter D. Ross of Wiley, Rein & Fielding, met with John Winston, Director of FCC Office of Small Business Affairs; at 2:00 p.m. with Maureen O'Connell, Legal Advisor to Chairman Quello; at 3:00 p.m. with Bill Johnson, Deputy Chief of Mass Media Bureau and Pat Donovan, Deputy Chief of Cable Services Division; at 4:00 with Byron Marchant, Senior Legal Advisor to Commissioner Barrett; and at 4:30 p.m., with John Hollar, Senior Legal Advisor to Commissioner Duggan. The discussion related to the attached issues raised in the above-named companies' pleadings in the cable rate regulation dockets cited above.

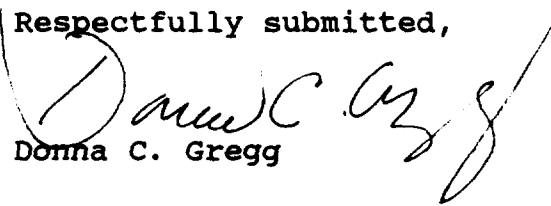
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Mr. William F. Caton
Secretary
October 27, 1993
Page 2

Kindly direct any questions regarding this matter to the undersigned.

Respectfully submitted,


Donna C. Gregg

DCG/ddl
Attachment

cc: John Winston
Bill Johnson
Pat Donovan
Maureen O'Connell
Byron Marchant
John Hollar

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**Why the FCC Should Alter Its Position on
Rate Base Allowance for Tax Liability of
Subchapter S Corporations and Similar Entities**

Under both the benchmark approach (as regards cost-based charges for equipment)¹ and cost-of-service approach as currently proposed,² the Commission has critically omitted an allowance for tax liability in the revenue requirement for cable companies organized as Subchapter S corporations or partnerships.

Explanation of Tax Liability of Subchapter S Corporation

- Congress enacted Subchapter S to minimize the effect of Federal income taxes on choices of the form of business organization and, in particular, to permit the incorporation and operation of certain small businesses without the incidence of income taxation at both the corporate and shareholder levels. In Subchapter S corporations, the income attributable to the operation of the business is taxed at the shareholder level, whether or not distributed. If the corporation does not generate sufficient revenue to provide for payment of taxes attributable to the corporation's income, the corporation will be unable to adequately fund its cash expenditure requirements or attract investors. Although the corporation itself does not cut the check to the taxing authority, the cash needed to meet the tax liability is a normal business outlay of the corporation

¹ First Report and Order on Reconsideration in MM Docket No. 92-266, FCC 93-428 (released Aug. 27, 1993) at ¶ 59.

² Notice of Proposed Rulemaking, MM Docket No. 93-215, FCC 93-353 (released July 16, 1993) at ¶ 30.

and an essential element of that corporation's revenue requirement.

Impact of Failure to Provide Tax Liability Allowance for S Corporations

- **ARBITRARY:** The distinction the FCC draws between its treatment of S Corporations and C Corporations is a distinction without a difference in economic impact for the cable operator.

The economic impact of not providing an allowance for tax liability on the regulated entity is the same for a Subchapter S corporation as it would be for a regular C corporation. Some of the Sub S company's earnings go to payment of shareholders' taxes and thus are not available for other purposes such as upgrading or expanding the business.

In addition, the Commission's willingness to provide a rate base allowance for tax liability does not appear to be based on actual payment of taxes; the Commission provides an allowance for tax liability for a regular C Corporation, even if that corporation did not actually owe any taxes because of losses.

- **CONTRARY TO ESTABLISHED LEGAL PRECEDENT:** State Public Utility Commissions, State Supreme Courts and even the U.S. Supreme Court have ruled that the rates charged by rate-regulated entities organized as sole proprietorships or Subchapter S corporations should include recovery for tax liability. For example, the Supreme Court of Texas has reasoned that "[t]he income taxes required to be paid by shareholders of a Subchapter S corporation on a utility's income are inescapable business outlays and are directly comparable with similar corporate taxes which would have been imposed if the utility operations had been carried on by a corporation. The elimination from cost of service is no less capricious than the excising of salaries paid to a utility's employees would be." Suburban Util. Corp. v. Pub. Util. Comm. of Texas, 652 S.W.2d at 364.
- **UNFAIR AND DISCRIMINATORY TO SMALL BUSINESSES:** Like the cable companies described in Attachment 2, most Subchapter S corporations tend to be small businesses. In fact, S corporations were specifically designed by Congress to encourage small business. (Many other small businesses organize as partnerships to overcome difficulties obtaining capital.) The Commission's policy on tax treatment of forms of business

organization frequently favored by small businesses is yet another example of the regulations' disproportionately greater burden on small cable operators.

ATTACHMENT A LEGAL PRECEDENT

Galveston Electric Co. v. City of Galveston, 258 U.S. 388, 399 (1922).

Suburban Util. Corp. v. Pub. Util. Comm. of Texas, 652 S.W.2d 358, 364 (Tex. 1983).

Moyston v. New Mexico Pub. Serv. Comm., 412 P.2d 840, 847-851 (N.M. 1966).

Application of Ingram Water Supply, Docket No. 2818, 6 P.U.C. Bulletin 579, 586 (May, 1981).

Application of B & B Water Systems, Inc., Docket No. 2351, 4 P.U.C. Bulletin 1528, 1531 (May, 1979).

ATTACHMENT B

Company	Shareholders	Organized As	# Systems	Total # Subscribers	Av. Subs Per Headend
Bend Cable Communications, Inc.	1	Sub S Corp.	1	16,000	n/a
River Valley Cable TV	1	Sub S Corp.	1	3,600	n/a
Etan Industries, Inc.	1	Sub S Corp.	40	44,461	1,112
ParCable, Inc.	4	Sub S Corp.	4	20,000	5,000
Star Cable Associates	n/a	Limited Partnership	60	61,000	1,116